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Arizona Corporation Commission

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IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE
INVESTIGATION OF THE COST OF
TELECOMMUNICATIONS ACCESS

DOCKET NO. T-00000D-00-0672

AT&T'S MOTION FOR LEAVE TO
FILE A RESPONSE TO QWEST'S
OMNIBUS REPLY

AT&T Communications of the Mountain States, Inc. and TCG Phoenix
(collectively, "AT&T") move for leave to file a response to Qwest Corporation's
("Qwest") Omnibus Reply in Support of Qwest's Motion to Revise Productivity Factor.

In Qwest's Motion, Qwest argues, based on the Affidavit of Philip E. Grate, that
the recent productivity rates for Qwest for the years 1999-2002 justify changing the
productivity factor. As AT&T pointed out in its response, Qwest provided no underlying
work papers or data sources. AT&T's Response at 2. In addition, AT&T pointed out
that "there is no *a priori* reason to expect such extreme volatility, except to the extent that
some extraordinary event may have occurred that would have produced such a result."

Id. at 3. AT&T pointed out that the only “event” that occurred during the time frame was the June 2000 merger of U S WEST and Qwest. *Id.*

In its Omnibus Reply, Qwest relies on data from the years 1989 through 2002 to respond to the volatility argument raised by AT&T. Qwest’s Reply at 4-5. However, Qwest’s Reply suffers from the same defects as Qwest’s original Motion. Qwest provides no underlying work papers or data sources, and Qwest provides no evidence that explains the basis for the volatility in the 14-year data.

Qwest’s Omnibus Reply suggests that the volatility for the 4-year period should not be considered abnormal because there were significant changes in productivity growth rates for the 14-year period. However, Qwest’s reliance on the 14-year productivity growth rates provides no justification for the volatility reflected in original productivity growth rates contained in Mr. Grate’s original affidavit and exhibits. Unexplained volatility for the 14-year period provides no justification for unexplained volatility for the 4-year period. AT&T has done some preliminary investigation for the 14-year period and has discovered four events that likely explain the negative productivity growth rates for the years 1991 and 1992. *See* Affidavit of Dr. Lee Selwyn attached to AT&T’s Response to Qwest’s Omnibus Reply attached hereto as Exhibit A.

Qwest’s initially relied only on 4 years to justify its productivity factor. To allow Qwest to rely on prior years to support its analysis without providing AT&T an opportunity to respond will prejudice AT&T. Qwest’s attempts to change the productivity factor by filing a Motion is highly unusual. It also denies the parties the opportunity to file discovery and the right to cross-examine witnesses.

Therefore, AT&T respectfully requests leave to file a response to Qwest's Omnibus Reply to AT&T's argument regarding the volatility of Qwest's productivity growth rates.

Submitted this 9th day of April, 2004.

**AT&T COMMUNICATIONS OF THE
MOUNTAIN STATES, INC. AND TCG
PHOENIX**

By 

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BEFORE THE ARIZONA CORPORATION COMMISSION

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Commissioner

**IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN**

DOCKET NO. T-01051B-03-0454

**IN THE MATTER OF THE
INVESTIGATION OF THE COST OF
TELECOMMUNICATIONS ACCESS**

DOCKET NO. T-00000D-00-0672

**AT&T'S RESPONSE TO
QWEST'S OMNIBUS REPLY**

AT&T Communications of the Mountain States, Inc. and TCG Phoenix
(collectively, "AT&T") hereby file their response to Qwest Corporation's ("Qwest")
Omnibus Reply in Support of Qwest's Motion to Revise Productivity Factor.

I. INTRODUCTION

AT&T will limit its response to Qwest's new reliance on the annual productivity
growth rates for the 14-year period 1989 through 2002 to justify the calculations in
Qwest's original Motion.¹ This information suffers from the same problems as the

¹ Although Qwest produced this information in its initial Motion, it did not rely on this data to support its position. Furthermore, Qwest's attempt to change the productivity factor by filing a Motion without a hearing and cross-examination of witnesses is highly unusual. Therefore, in all fairness, AT&T must be provided an opportunity to respond. However, in addition, Commissioner Mundell has invited parties to respond to Qwest's Motion in his letter to his Colleagues dated March 26, 2004.

productivity rates relied on by Qwest in its original Motion and in Mr. Phillips E. Grate's initial affidavit: principally, Qwest fails to adjust the data for extraordinary events.

II. ARGUMENTS

In Qwest's Motion, Qwest argues, based on the Affidavit of Philip E. Grate, that the recent productivity rates for Qwest for the years 1999-2002 justify changing the productivity factor.² As AT&T pointed out in its response, Qwest provided no underlying work papers or data sources. AT&T's Response at 2. In addition, AT&T pointed out that "there is no *a priori* reason to expect such extreme volatility, except to the extent that some extraordinary event may have occurred that would have produced such a result." *Id.* at 3. AT&T pointed out that the only "event" that occurred during the time frame was the June 2000 merger of U S WEST and Qwest. *Id.* In addition, AT&T, pointed out a number of other issues that may have caused the changes in Qwest's productivity rate and that would need to be taken into consideration in establishing a productivity factor for Qwest.

Qwest relies on data from the years 1989 through 2002 to respond to the volatility argument raised by AT&T. Qwest's Reply at 4-5. However, Qwest's Reply suffers from the same defects as Qwest's original Motion. Qwest provides no underlying work papers or data sources, and Qwest provides no evidence that explains the basis for the volatility in the 14-year data. AT&T has done some preliminary investigation for the 14-year period and has discovered four events that likely explain the negative productivity growth rates for the years 1991 and 1992. *See* Affidavit of Lee L. Selwyn attached hereto as Exhibit A. On January 1, 1991, the Bell operating companies Northwestern Bell

² Qwest's Motion does not recommend a factor. Based on paragraph 5 of Exhibit 1 to Qwest's Motion, AT&T assumes Qwest wishes to set the productivity factor at zero.

Telephone Company and Pacific Bell Telephone Company merged into The Mountain States Telephone and Telegraph Company, which was renamed U S WEST Communications, Inc. Selwyn Affidavit at 4. Effective January 1, 1991, the Federal Communications Commission adopted several separations and accounting changes. *Id.* at 4-5. In 1992, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard 106 regarding the treatment of post-retirement benefits other than pensions. *Id.* at 5. Dr. Selwyn states that “[o]ne-time occurrences such as these are exactly the type of extraordinary events that would be expected to produce significant fluctuation in the results of an accounting-driven TFP analysis of the type sponsored by Mr. Grate, and the fact that such variations have occurred in the past serves only to underscore this point.” *Id.*

Qwest’s reliance on the 14-year productivity growth rates provides no justification for the volatility reflected in original productivity growth rates contained in Mr. Grate’s original affidavit and exhibits. Unexplained volatility for the 14-year period provides no justification for unexplained volatility for the 4-year period. In fact, Qwest’s reliance on the 14-year productivity growth rates provides further support for Dr. Selwyn’s position that “Mr. Grate’s ‘Arizona Productivity Analysis’ cannot be taken at face value, and will require considerable examination and adjustment before it can be relied upon as a credible source of information on Qwest’s productivity results for Arizona,” *id.* at 2-3, and that “it is highly unlikely that the productivity factors as presented by Qwest and Mr. Grate are correct, and it is highly likely that Qwest’s actual productivity growth is considerably greater than as portrayed by Mr. Grate.” *Id.* at 6.

For all the reasons contained in AT&T's Response and this pleading, Qwest's Motion should be denied.

Submitted this 9th day of April, 2004.

**AT&T COMMUNICATIONS OF THE
MOUNTAIN STATES, INC. AND TCG
PHOENIX**

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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF QWEST
CORPORATION'S FILING AMENDED
RENEWED PRICE REGULATION PLAN

Docket No. T-01051B-03-0454

IN THE MATTER OF INVESTIGATION OF
THE COST OF TELECOMMUNICATIONS
ACCESS

Docket No. T-00000D-00-0672

COMMONWEALTH OF MASSACHUSETTS)

) ss.

COUNTY OF SUFFOLK)

AFFIDAVIT OF LEE L. SELWYN

Lee L. Selwyn, of lawful age being first duly sworn on oath, deposes and says as follows:

1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc.
("ETI"), Two Center Plaza, Suite 400, Boston, Massachusetts 02108. ETI is a research and

consulting firm specializing in telecommunications and public utility regulation and public policy. A statement of my qualifications is attached hereto and made a part hereof.

2. On March 15, 2004, Qwest Corporation ("Qwest") submitted a *Motion to Revise Productivity Factor*. Qwest's *Motion* was accompanied by the Affidavit of Philip E. Grate, sponsoring an "Arizona Productivity Analysis" purporting to calculate the rate of total factor productivity (TFP) growth allegedly experienced by Qwest with respect to its Arizona intrastate services over the four-year period from 1999 through 2002. At the request of counsel for AT&T Communications of the Mountain States, Inc. ("AT&T"), I reviewed the Qwest "Arizona Productivity Analysis" and assisted counsel with the preparation of AT&T's Response, which was filed on March 15, 2004. I am familiar with the contents thereof, and the factual statements contained therein at pages 2-9 are true and correct to the best of my knowledge, information and belief.

3. Qwest filed a reply to AT&T's Response on March 31, 2004.¹ In that filing, Qwest attempts to dismiss the anomalous variability in its claimed productivity growth experience by demonstrating that "significant changes in the absolute value of the productivity data have been the norm, not the exception over [the] period [from 1989 through 2002]."² This utterly

1. Omnibus Reply in Support of Qwest's Motion to Revise Productivity Factor, filed by Qwest Corporation, March 31, 2004 ("Reply"). Qwest's Reply also responds to the comments of the Commission Staff and the Residential Utility Consumer Office.

2. *Id.*, at 4.

remarkable argument – which seeks to rationalize the use of obviously polluted data on the absurd basis that similarly anomalous *and unexplained* results have been observed in the past – actually confirms and corroborates AT&T's conclusion that Mr. Grate's "Arizona Productivity Analysis" cannot be taken at face value, and will require considerable examination and adjustment before it can be relied upon as a credible source of information on Qwest's productivity results for Arizona.

4. With respect to the year-over-year variation in Qwest's TFP growth as determined by Mr. Grate's analysis, AT&T's March 15, 2004 Response noted that "there is no *a priori* reason to expect such extreme volatility, except to the extent that some extraordinary event may have occurred that would have produced such a result." Although Qwest now claims that such variability is the norm rather than the exception, its March 31 Reply does not even *mention*, let alone refute or deny, AT&T's observation that the "extraordinary event" that likely produced the -7.2% TFP growth that Mr. Grate claims to have occurred between 2000 and 2001 was the result of one-time integration and reorganization costs driven by the 2000 merger of U S WEST into Qwest. If accounting data of the type being relied upon by Qwest is to be used as a basis for assessing historic annual productivity growth rates, as Qwest has done here, then it is essential that such data first be carefully analyzed and adjusted to remove the effects of any extraordinary events that have nothing to do with actual productivity experience.

5. In its Reply, Qwest shows negative productivity growth in 1989, 1991, 1992, 2000 and 2002, but makes no mention of specific extraordinary events that likely contributed to those

anomalous results. In its March 15 Response, AT&T suggested possible sources of the negative results for 2000 and 2002. Even more significant extraordinary events – including the 1991 merger of (then) U S WEST's three separate Bell Operating Companies and several accounting and separations changes – may well fully explain the -6.4% and -2.8 TFP growth being claimed by Mr. Grate for 1991 and 1992:

- On January 1, 1991, the separate U S WEST Bell Operating Companies – Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company – were merged into The Mountain States Telephone and Telegraph Company, which was then renamed U S WEST Communications, Inc. The U S WEST 10-K for 1993 identifies some \$363.8-million in “Reserves related to 1991 business restructuring, including force reductions and the write-off of certain intangible assets” that are shown as having been “charged to expense” in 1991.³ Mr. Grate's data indicate a \$30.8-million jump in Arizona intrastate non-capital expenses for 1991 over 1990. Any “business restructuring” expenses that are included in Mr. Grate's 1991 expense figure must be removed before TFP can be determined.
- In its *LEC Price Cap Order* issued in October 1990, the FCC adopted several separations and accounting changes that became effective as of January 1991.⁴ At a minimum, these

3. U S WEST Form 10K, Consolidated Statements of Income, December 31, 1993.

4. *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, *Second Report and Order*, October 4, 1990, 5 FCC Rcd 6786.

changes make pre- and post-1991 data noncomparable without adjustment; it is not apparent that any such adjustments have been incorporated into Mr. Grate's TFP calculations for those years.

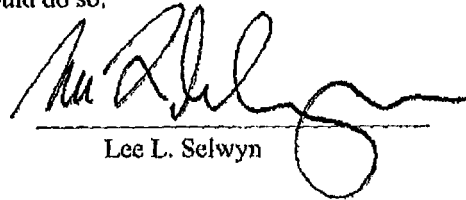
- Another accounting change that occurred in 1992 involved the treatment of post-retirement benefits other than pensions. Prior to the issuance of Statement of Financial Accounting Standard ("SFAS") 106 by the Financial Accounting Standards Board ("FASB"), these non-pension benefits were expensed on a pay-as-you-go basis; under the new rules, post-retirement benefits had to be accrued as an expense *at the time that the employee wages were paid*, and previously obligated but as-yet-unaccrued post-retirement benefits had to be expensed via an amortization over 20 years.⁵ The effect of these accounting changes is to permanently increase booked expenses, further contributing to the non-comparability of pre- and post-1992 results.

One-time occurrences such as these are exactly the type of extraordinary events that would be expected to produce significant fluctuation in the results of an accounting-driven TFP analysis of


5. *Southwestern Bell GTE Service Corporation Notification of Intent to Adopt Statement of Financial Accounting Standards No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions*, AAD 91-80, Order, DA 91-1582, 6 FCC Rcd 7560 (1991). The FCC authorized all carriers to adopt SFAS-106 accounting on or before January 1, 1993. The U S WEST 1993 10-K reports a charge of \$1.7-billion in 1992 attributed to the "Cumulative effect of change in accounting principles (accounting for postemployment and postretirement benefits), net of tax."

the type being sponsored by Mr. Grate, and the fact that such variations have occurred in the past serves only to underscore this point. Year-over-year variations in apparent TFP would also be caused by inconsistencies in the *timing* of asset acquisitions and retirements, organizational changes, and any number of other business situations. Given that the incidences of negative productivity growth happened to coincide with identifiable events each and all of which could well account for precisely that apparent outcome, it is highly unlikely that the productivity factors as presented by Qwest and Mr. Grate are correct, and it is highly likely that Qwest's actual productivity growth is considerably greater than as portrayed by Mr. Grate.

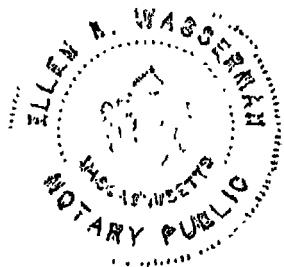
The foregoing statements are true and correct to the best of my knowledge, information and belief, and if called to testify thereon I could do so.


Lee L. Selwyn

Sworn to before me this 8th day of April, 2004


Notary Public

My Commission expires 3/31/06



CERTIFICATE OF SERVICE

(Docket No. T-01051B-03-0454, T-00000D-00-0672)

I certify that the original and 15 copies of AT&T's Motion for Leave to File a Response to Qwest's Omnibus Reply were sent by overnight delivery on April 9, 2004 to:

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1200 West Washington Street
Phoenix, AZ 85007

and a true and correct copy was sent by overnight delivery on April 9, 2004 to:

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